

A PUBLICATION OF THE NEW JERSEY DIVISION OF PENSIONS AND BENEFITS

Taxation of Retirement Benefits

All Funds

HOW ARE MY PENSION BENEFITS TAXED FOR FEDERAL PURPOSES?

Pension benefits (except for Accidental Disability and Accidental Death benefits) are subject to federal income tax; however, if you paid tax on any of your contributions to the pension plan, that portion of your monthly benefits representing a return of your previously-taxed contributions is not taxable.

Contributions made to the pension plan prior to January 1, 1987 were already taxed as were any purchases of optional pension membership credit made before 2002. After January 1, 2002 some purchases may have been made with previously-taxed money. Therefore, if you began contributing to the pension plan prior to January 1, 1987, or if you purchased pension membership since then, all or a portion of your total contributions may have been previously subject to federal tax.

The rate at which you can recover your previously-taxed contributions is determined in part by your retirement date.

If you retired before August 1, 1986 — you were able to fully recover your contributions before having to pay tax on your benefits. Once you recovered your contributions, your benefits became fully taxable. *The exception is if you did not fully recover your contributions within the first three years of retirement. In that case, you had to recover your contributions under the IRS expected return rule explained below.*

If you retired on or after August 1, 1986 — you must recover your contributions under the expected return rule. Under this rule, you recover your contributions evenly over your expected lifetime or the combined lifetime of you and your pension beneficiary. This means that only a small portion of each monthly benefit is considered a return of your previously-taxed contributions and is tax-free.

CALCULATING THE NON-TAXABLE AMOUNT

If you retired after July 1, 1986 and before November 1, 1996 — your monthly nontaxable amount is determined using life expectancy tables found in IRS Publication 939.

If you retired on or after November 1, 1996 — the following tables are used to determine your monthly nontaxable amount:

TABLE A

Benefits Payable To Retiree Only*

Age of Retiree (at retirement)	Number of Payments
55 or less	360
56-60	310
61-65	260
66-70	210
71 or more	160

**For those retired on or after November 1, 1996 and before December 1, 1997, Table A is used even if benefits are payable to the retiree and the retiree's survivor.*

TABLE B

Benefits Payable To Retiree and Beneficiary

Combined Age of Retiree (at retirement) & Beneficiary	Number of Payments
110 or less	410
111-120	360
121-130	310
131-140	260
141 or more	210

The following examples illustrate how the monthly nontaxable amount is computed using Tables A and B:

Example 1 — A PERS member whose previously-taxed contributions equaled \$12,000 retires at age 62 and chooses to receive the maximum allowance (designating no monthly pension to a surviving beneficiary). **Table A** is used because benefits are payable to the retiree **only**. The \$12,000 is divided by 260 which produces a monthly tax-free amount of \$46.15. The balance of the monthly pension is subject to federal income tax.

Example 2 — A TPAF member whose previously-taxed contributions equaled \$15,000 retires at age 60 and chooses to receive benefits under Option 2 (designating the same monthly pension to the surviving beneficiary). **Table B** is used because benefits are payable to the retiree **and** the retiree's beneficiary. The designated beneficiary is the same age as the retiree. The \$15,000 is divided by 360 which produces a monthly tax-free amount of \$41.67. The balance of the monthly pension is subject to federal income tax.

HOW LONG WILL THE NON-TAXABLE PORTION CONTINUE?

For those who retired after December 31, 1986 the monthly nontaxable amount remains in effect until all of your previously-taxed contributions are fully recovered. At that point your benefits become fully taxable.

For those who retired before December 31, 1986 the monthly nontaxable amount is effective for as long as you or your survivor receive benefits.

If benefits cease before your previously-taxed contributions are fully recovered, the remaining balance can be claimed as a deduction on the income tax return of the last recipient, provided you retired on or after July 1, 1986. If you retired before July 1, 1986, no deduction is allowed for unrecovered contributions.

WITHHOLDING FEDERAL INCOME TAX FROM YOUR PENSION CHECK

Each new retiree will automatically receive a federal withholding tax form (W4-P) near the date of retirement. The Division of Pensions and Benefits is required by federal law to **automatically withhold federal income tax** from your pension check, based on a status of married with three allowances if you

do not complete a W4-P. The W4-P allows you to elect no withholding or, if you want withholding, to inform us of your tax filing status so that we can withhold the proper amount.

WITHHOLDING NJ STATE INCOME TAX FROM YOUR PENSION CHECK

If you live in New Jersey you will automatically receive a New Jersey State withholding tax form (NJ W4-P) near the date of retirement. Most retirees will not be subject to New Jersey income tax until they recover in pension checks the amount of the contributions which they made to the pension plan while working. If you will not recover your total contributions within three years of retirement, refer to your NJ Gross Income Tax Return Form 1040 booklet to determine how your pension is taxed.

If you are at least 62 or considered disabled by Social Security, you may exclude the following amounts of retirement income from New Jersey income tax for the tax year indicated below:

<u>Tax Year</u>	<u>Married Filing Jointly</u>	<u>Single</u>	<u>Married Filing Separately</u>
2000	\$12,500	\$9,375	\$6,250
2001	\$15,000	\$11,250	\$7,500
2002	\$17,500	\$13,125	\$8,750
2003 and beyond	\$20,000	\$15,000	\$10,000

Unlike federal income tax, **withholding for New Jersey income tax is completely voluntary**. No New Jersey income tax will be withheld unless you authorize it by completing a NJ W4-P. The amount withheld must be at least \$10.00 per month and in even dollar amounts (no cents). If you need help deciding whether to have this withheld or how much to have withheld, you can contact the New Jersey Division of Taxation at 1-800-323-4400.

If you live outside New Jersey, you are not required to pay New Jersey income tax on the pension you receive from the retirement system. The Division of Pensions and Benefits does not withhold income tax

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for other states. Check with your home state's tax office to determine if your pension is taxable in your state of residence.

CHANGING YOUR WITHHOLDING AMOUNT

If you wish to change your withholding **you must submit a new form** which you can obtain by calling the Division of Pensions and Benefits - Benefits Information Library (BIL) 24 hours a day, seven days a week, at (609) 777-1931 (if you have a touch-tone telephone). When your call is answered, press 122 on the key pad of your telephone. At the end of the message you can leave your name, address, and Social Security number, and a federal (or State) withholding form will be sent to you. If you are already having **more than the minimum** federal tax withheld, you should contact the Division of Pensions and Benefits at (609) 292-7524 for assistance in completing the form.

**QUESTIONS COMMONLY ASKED
AFTER RETIREMENT****Will I receive a statement of
pension income for tax purposes?**

Yes. Retirees receive Form 1099-R at the end of January each year, covering the previous tax year. This shows the gross retirement allowance; how much is subject to federal income tax; and the amounts, if any, that were withheld for federal and New Jersey income tax.

**Am I taxed on the
reimbursement of Medicare premiums?**

No. Some State employees and all employees of

boards of education or county colleges who retired with 25 or more years of service, or on a disability retirement, who are enrolled in the State Health Benefits Program are reimbursed in their pension checks for the Medicare Part B premiums they pay to Social Security. If you receive this Medicare reimbursement, the gross amount of your pension checks will be greater than the gross amount shown on your 1099-R because the Medicare reimbursement is not taxable. The Medicare premium reimbursement is subtracted from your total gross income to arrive at the gross pension reported to the IRS.

**Why doesn't my gross allowance equal 12 times
the amount of my December 1 check?**

When you receive a cost-of-living increase, your pension is changed each year with the February 1 check. Therefore, the gross allowance for your January 1 check is less than your next 11 checks.

Is my disability pension taxable?

If you are receiving a disability pension, your benefits are not subject to New Jersey income tax until you reach age 65.

If you are receiving an *Accidental* Disability pension, — or if you are a survivor receiving *Accidental* Disability or *Accidental* Death benefits — the Division of Pensions and Benefits reports your benefit as exempt from federal income tax.

Ordinary Disability pensions are subject to federal tax to the same extent as other pensions. Any questions should be referred to the IRS at the number listed below.

**THE DIVISION OF PENSIONS AND BENEFITS CANNOT GIVE TAX ADVICE.
CONSULT THE IRS (1-800-TAX-1040), OR THE NJ DIVISION OF TAXATION (1-800-323-4400 in NJ),
OR YOUR TAX ADVISOR FOR ASSISTANCE.**

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Although every attempt at accuracy is made, it cannot be guaranteed.